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2-15-2003

# Evolutions of Institutions in China

Sun He

*South Dakota State University*

John Sondey

*South Dakota State University*

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### Recommended Citation

He, Sun and Sondey, John, "Evolutions of Institutions in China" (2003). *Department of Economics Staff Paper Series*. Paper 167.  
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# **EVOLUTIONS OF INSTITUTIONS IN CHINA**

**by**

**SUN HE**

**Economics Staff Paper 2003-2**

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**1. All correspondence should be directed to John A. Sondey, South Dakota State University, Dept. of Economics, Scobey Hall, Brookings, South Dakota 57007-0895. Phone number: 605-688-4873. Fax number: 605-688-6386. Email [john\\_sondey@sdstate.edu](mailto:john_sondey@sdstate.edu).**

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# Evolution of Agricultural Institutions in China

Sun He<sup>1</sup>

John A. Sondey<sup>2</sup>

## 1.introduction

Economic reforms in rural development are of special significance to the future of agriculture in China and hence the Chinese economy. This paper follows the trend of changes in agricultural institutions in China, and explains the reasons why those reforms should occur and the direction they would give the Chinese economy. Unlike many articles which have described China's reforms as a process of the government's self-selection, this paper considers the variety of forces pushing Chinese reforms in agriculture forward; not only government's policies but also farmers' reactions to and their interactions with farm policy.

Since 1978, many policies directed at the agricultural and rural economy have been proposed and implemented. Some have promoted formation of market mechanisms for agricultural products, and some have not. The goals of some policies seem to sometimes contradict one another. Some policies have been constantly advanced by the authority, and some were offered only as temporary expedients. For example, the "rice bag" policy, meant to enhance self-sufficiency in grain production, was proposed only when grain prices spiraled upward in 1995, as the demand for grain grew faster than supply. Some newer policies were reminiscent of the old planned economy, but it was

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<sup>1</sup> Sun He from the school of economics and trade, Yunnan Agricultural University, China, is a visiting professor in the economics department of South Dakota State University.

<sup>2</sup> John A. Sondey is a professor in the economics department of South Dakota State University.

impossible for them to be carried out as the structure that supported their implementation had disappeared. For example, the effort to maintain wholesale prices of grain at a higher level than equilibrium to cover the losses of the state-owned grain procurement firms, became fruitless during 1996-1999. State firms hoarded too much grain to resell in view of their higher procurement prices and business costs. Farmers and other firms sold grain at lower prices, and state firms even competed with one another. This paper regards the institutional arrangements of the rural land and market of agricultural products as the leading element in changing the agricultural institutions in China.

## **2.The institutional arrangements of agricultural production organization before 1978.**

The People's Republic of China was born in 1949. Land formerly owned by landlords was expropriated by the state and distributed to farmers who had had no or little land. Under this arrangement, land was still privately owned and only the area of land owned per family was restricted. This institution of land ownership worked well, and it (through a tax in-kind) provided the authority with sufficient food to make the social order more stable.

Primary producers' cooperatives began to be created in 1955. Farmers were organized to work together, and their land, large animals, and farm machinery were pooled and factored into shares of cooperatives' assets which, in turn, would pay dividends to shareholders. In 1956 and 1957, cooperative movements were launched, and several primary cooperatives were incorporated into a higher producers' cooperative where farmers relinquished individual ownership of land and other production resources,

which became collective property. This process reached its summit in Great Leap Forward of 1958. A number of higher producers' cooperatives were pooled to form a people's commune, which was organized much like an army. The Chinese leader, Mao Ze Dong, explained the features of people's communes, stating: the first thing (for people's communes) is large, and the second public. Usually, a commune was populated by 50,000-200,000 people, and some communes exceeded three hundred thousand. The commune owned the land and other production resources, except that members of the commune could privately own some small, simple tools. A branch party secretary, sent by the party committee at the county level, was in charge of agricultural production, which followed a central plan, as did education, sanitation, public security, and every other aspect of social life.

In 1958, serious problems arose in the agricultural component of the Great Leap Forward. The distribution of food in communal dining halls was based in part on the needs of individuals and, in part, on work performed. Some dining halls consumed the food intended for an entire year in several months. Members of communes didn't know what and how much they would gain from their work-efforts, so it was inevitable that productivity was low.

Concurrent with the agricultural cooperative movement, the institution of state purchases and sales of farm commodities was established. Nearly all agricultural products produced by communes had to be sold to the stipulated state-owned agents at low regulated prices. In turn, those agents sold them to urban residents at low fixed plan prices as part of the "iron rice bowl".

The end result of Great Leap Forward was an economic disaster but the lesson remains valuable today. Grain production fell sharply in 1960-1962, which was called the “three-years of difficulties” or “three-year adjustments”. The Chinese population was drastically reduced by more than ten million due to starvation and disease<sup>3</sup>.

To overcome organizational difficulties, the institution of the people’s commune was modified to some extent. The commune’s dining halls were abolished. Members of communes were given a small plot of land to grow their own food, which accounted for approximately five percent of total land area; while a large percentage of land still remained in public ownership and usage. One of most important modifications was that the party secretary of the commune no longer controlled production activities directly, according to the theory of three-level’s ownership for land. This theory stated that the commune and its subordinated “brigades” and “teams” together own the land. However, “teams” were designated as the fundamental units of production. The team organized routine production activities and distributed output among its members, after fulfilling the quotas at a very low price to the state. Leaders of communes and brigades monitored and examined the effectiveness of production teams under the guidelines of the central plans.

A commune member worked a day, and received a working score for his labor. Scores differed among members in a team due to gender and age. There were few tangible incentives to spur members’ efforts because of the many aspects of agricultural production, such as differing lengths of time to produce diverse agricultural products, the huge land area, different labor amounts and operations needed in different stages of the production process. All this made it very difficult to monitor and measure commune members’ working efforts. The share of agricultural output that a member obtained was

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<sup>3</sup> See the series data of population in China’s statistical year book, 1990.

proportionately distributed on the basis of his total working scores at the end of a year. If a commune member contributed a certain effort, the gain from this marginal effort will be distributed equally among all members. Therefore, commune members had no incentive to work hard, and the more members to a team, the weaker the incentive to produce. Moreover, the contribution of individual effort in the total collective output was not recognized, so members inclined to be free riders. Also, a team had less desire to work hard since the state took a quota of its output at a low price. This system of management mitigated starvation, but didn't solve the problem of the inherent inefficiency of communes.

“Great Proletarian Cultural Revolution” implemented during 1966-1977, made further changes and modifications in the commune systems. Although the Cultural Revolution was directed by the radical idealists and drastically reduced industrial production, the radicals focused their energy in urban areas and had less time for the communes in rural areas. Thus, the Cultural Revolution had little influence on the rural economic system.

### **3. Reforms of agricultural production organizations after 1978.**

To spur agricultural production, the government began to raise the prices they paid by agricultural products after 1970. Meanwhile, China, of necessity, began to import grains on the world market. China was reluctant to do so because it worshiped self-sufficiency in agriculture. However, the shortage of food had always embarrassed the Chinese government, and the shortfall had become more and more serious as the population increased and the industrial sector grew.



Pragmatists took power again in China in 1978. The ideas of Deng Xiao Ping, “seek truth from facts”, prevailed. In Deng’s most typical words, that statement can be illustrated by “whether black cats or white cats, only those catching mice are good cats.” And important reforms occurred. The household responsibility system, launched by a few brave farmers in secrecy in Xiao Gang village of Fu Yang county, An Hui province, was officially adopted and extended to the whole rural sector. Under the household responsibility system, the land of a production team was divided into sub-plots, and then distributed to each farm family of the team. Each family was responsible for agricultural production on its plot of land. After the farmer sold a quota of his output to the state at a low price, his family got the remainder of output, and could sell the surplus on the unregulated market. Therefore, the problem of the lack of internal incentive under the team system was solved. Meanwhile, the government continually raised producer prices from 1978 to 1984. In 1984-85, China, for the first time, produced more grains than it internally consumed.

The Chinese authority relinquished controlled prices on most agricultural products over time. Farmers could sell vegetables, fruits, poultry and eggs, beef, lamb, pork, and other products on the unregulated market. The only remaining regulated prices on agricultural products were for grain staples and cotton. Even rice, wheat, corn, or cotton could be sold on unregulated markets so long as farmers gave the government the quotas imposed on them. The levels of quotas were usually kept constant. Therefore, the lack of external incentive was also relieved. The roles of communes and production teams disappeared and only the local government function remained. Hence, the names of communes and production teams were replaced by towns or villages in 1983.

In 1989-90, the producers of grain received a large price increase again, higher than the fixed retail prices of state-owned grain outlets. The operations of the state-owned firms, which purchased grains from producers and sold them to urban residents, survived only through the support of the government subsidies. But, the cost of subsidies became too heavy for the government budget to sustain. The government determined to eliminate the subsidies and permit the state-owned firms to raise and change the retail prices of grains to the level of the open market prices for grains in 1993. Thus, the united retail selling and ration system for urban residents was abolished, and the grain retail-market became nearly completely unregulated.

In many provinces, village collectives frequently redistributed land among villagers based on changes in population, and, sometimes land was redistributed every two or three years. Land plots of good quality and larger area often were redistributed to the relatives and friends of village heads, which made most farmers angry. In a series of laws passed after 1997, including the land decree of 2000, the central government enforced the stability of tenancy on land plots to ease farmers' resentment and in return for farmers' help for implementing the policy of birth control in rural areas. The "responsibility term"<sup>4</sup> of land was defined as a period of thirty years, in which land could not be redistributed. Desert and mountainous land was auctioned to the highest bidder and its responsibility term could stretch fifty to seventy years.

In 1993, a new arrangement regarding land was instituted in Pindu County, Shandong province, which was called as "two parts of a field plot". It divided the plot that each farmer was responsible for into two parts, one part was left to the family to

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<sup>4</sup>The time that farmers lease land from collectives is named as responsibility term in China. It was fifteen years before 1997.

produce food for the family's need, and the other part was allocated to the collective which centrally rented the land to a few, productive farmers. It was thought that the new arrangement could solve the problem of the smaller than efficient operating area scale which prevailed under household responsibility. The arrangement was extended to Shandong province and its neighbor provinces. However, most farmers disliked the new system, and they felt their personal rights were infringed because those designated as competent farmers tended to be the relatives and friends of village heads. However, their own land plots were reduced, and they managed to show their discontent in different ways. The central government recognized this problem and repeatedly requested that local governments stop their rearrangements and maintain the household responsibility system as it existed. The central government thought of that any arrangement regarding land should protect most farmers' benefits and respect farmers' own choices, and the solution for too small a scale of farming should be resolved by the marketplace instead of by government fiat.

Of course, the land responsibility system does not imply private-ownership of land in China. The state and village collective still hold important property rights. Farmers can only engage in certain, designated agricultural activities. For example, a farmer has no right to change his crop growing plot into a fishing pond without the approval of local governments. Another important right the state holds is the ability to requisition land at a low price from farmers for public use. However, local governments often abuse their rights to requisition land, and expropriate land from farmers and their collectives and sell it to commercial organizations. County governments can receive seventy percent of receipts from selling land, collectives more than twenty percent, and

farmers receive only five or seven percent of receipts. Moreover, the representatives of collectives sometimes use collective receipts for their personal purposes.

In 1994-95, there was a shortfall in grain supplied by Chinese farmers, frustrated by the relatively low prices of grains. To counter the shortfall, the government raised its procurement price sharply. At the same time, it enforced its policy of “grain bag” which meant each locality and its government was responsible for resolving its own problem of shortage. The policy implied self-sufficiency of grain production at the local level. However, the effects of the “grain-bag” policy were insignificant, as it proved impossible to carry out. The best choice for the Chinese government would be to raise the grain procurement price to ensure the planted area plan was carried out after the land household responsibility system had been built up. Farmers and local governments in relatively developed regions, such as Zhejiang, Jiangsu, Shandong and Guangdong provinces, had no incentive to plant wheat, rice, and other grain crops because there was no comparative advantage in doing so. Many farmers preferred bearing the penalty rather than waste the land for which they were responsible. China enjoyed a large harvest of grain in 1996, after grain procurement prices had been significantly raised in 1994-1996. Output of grain remained at high levels in the following years, as the procurement price was kept high to protect farmers’ income. In 1998, new problems arose. Huge quantities of grain began to heap up in simple barns that were temporary in nature, and a large investment was needed to build modern barns. Complicating the problem, the grain which the government purchased could not be sold because the state-owned grain companies had high costs and farmers could sell their surplus at a more competitive price on the open market. The left-over grain, after farmers carried out the procurement

contracts, was stocked in farmer's homes since state-owned companies had insufficient funds to purchase it. State-owned companies could not repay loans owed to the state-owned Agricultural Development Bank, and left the government bearing a big financial burden, reaching more than 200 billion RMB yuan in 1999. The government then began to adjust its policies.

#### **4. Recent policies affecting agriculture and farmers**

Today, the "Grain bag" policy has been modified. It is no longer necessary that local governments are self-sufficient in grain production, and it is acceptable to allow the market mechanism to maintain stability in grain markets. Thus, the central and local governments can use grain reserves and international or extra-regional grain markets to restore equilibrium. Trade can be used to solve the shortage of grains and farmers can best choose what is to be grown by themselves, grain or otherwise. Governments do not need to impose a master plan of planting and grain procurement. Zhejiang province has been doing without government controls for two years, and from April 2002, other provinces have begun to do so, too. The farmers in Zhejiang would like to plant vegetables and fruits, which have strong local markets as the province embraces three metropolises, Shanghai, Hangzhou, and Ningbo. However, the Chinese government is cautious, and it allows only the regions whose consumption of grains are larger than their own production to do so, including Beijing, Shanghai, Zhejiang, Guangdong Jiangsu and Shandong. Those regions whose grain outputs exceed regional consumption are not allowed this choice in production.

China possesses tillable land of two billion mu; i.e. 0.33 billion acres. But, that land supports more than 0.8 billion in farm family population, and 0.43 billion farmers. Each farmer has, on average, less than one acre to plant. This plot size is minute, even when farming is conducted by hand. It is estimated that 0.3 billion in farm labor are underemployed in agriculture. In 2002, income, per capita, for the Chinese rural residents is less than one third of the income per capita for urban residents<sup>5</sup>. Income, per capita of household, was 2476 RMB yuen for rural residents, and 7703 RMB yuen for urban residents. It is said that the real income ratio for farmer residents is only sixth of that for urban residents when the social welfare urban residents enjoy is considered. Large differences of income and wealth exist between rural and urban residents, which become another source of social instability. To improve the welfare of farmers, China initiated the Decree of Rural Land Contract, beginning on March 1, 2003<sup>6</sup>. The decree officially admits the legalization of some rights of farmers to dispose of the land plots for which they are responsible. Farmers can earn income from the plot of land rented by a collective, put their plots into a firm as capital, own a share of its property, rent the plot to other persons, exchange their plots with each other, and grant the plot to others. Farmers' children can inherit the rights to the land plot that the collective rents to their parents. Most of those rights previously belonged to collectives, at least legally. Because of the rural-urban income disparity, millions of young farmers migrate to cities to look for work. When a farmer takes a job in a city he is termed a "farmer worker" in China. Authorities in cities fear the population influx will cause traffic jams, and increase crime,

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<sup>5</sup> The data of household incomes per capita of rural and urban areas from the Chinese official website, [www.peopledaily.com.cn/GB/shizheng/252/10307/10317/20030307/938723.html](http://www.peopledaily.com.cn/GB/shizheng/252/10307/10317/20030307/938723.html).

<sup>6</sup> The Chinese congress has already approved that law on the October of 2002, but the time to implement is set on March 1, 2003.

prostitution and other social problems. They detain the young migrant farmers and return them to their hometowns under guard. Meanwhile, due to the new prosperity of village and town enterprises, firms funded by foreigners, and privately owned companies in the coastal area of China, many new opportunities for employment have been created. On January 1, 2003, the Office of State Council issued a notice requiring local authorities to treat farmer workers more civilly. It is the first document aimed at protecting the rights of farmer workers.

## **5. Summary**

Reforms in Chinese agriculture, which will make for greater efficiency and productivity, appear to be on a clear track, though some reversals and setbacks have occurred. Agricultural institutions in China have gradually evolved from central command control and are becoming much more market oriented. Today, the primary agents of economic operations are farmer families rather than communes and production teams. Supply and demand of agricultural products is decided by the market in most situations. The government still regulates the procurement of cotton and a few staple grains. However, farmers can make free choices on a wide scope. Returning to a regime of central planning means going back to poverty, inefficiency, and greater inequity. Most of the Chinese people do not want to turn time back. China faces many problems at the moment, such as unemployment, disparity of income between groups of people or regions, and corruption. However, most Chinese people believe that these problems can be resolved only through economic development. Economic reforms are the main force pushing China's economic development.

The influence of the agricultural reforms in China exceeds the scope of agriculture, farmers, and rural development. Its effect on the whole economy and economic development nation-wide is also significant. Farmers released from the commune's rigorous regime have entered the non-agricultural sector, developing village and town industry, plus private enterprises. They have formed a new socio-economic group, "farmer workers". This means former farmers or residents still registered as rural residents now can take jobs in urban areas or the non-agricultural sector, which was strictly forbidden before 1980. More than ten million farmer workers have immigrated from other provinces to the developed Guangdong province. The Agriculture Department estimated that village and town enterprises today employ one hundred and thirty-three million farmer workers, larger than total employment in the state-owned sector. The value-added of the private sector in village and town enterprises accounts for seventy percent of the total value provided by village and town enterprises<sup>7</sup>. In Zhejiang province, the state-owned sector accounted for only seven percentage of the total GDP of 2002. Those factors, in addition to enormous foreign investment, make up the most active and positive forces driving the Chinese economy today.

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<sup>7</sup> The data comes from the web site of macro-economy of people's daily in China, 1-20-2003. <http://www.peopledaily.com.cn/GB/jinji/31/179/20030120/911022.html>.



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